STATE FINANCES

The Budget Process

The State's fiscal year begins on July 1 and ends on June 30. The State operates on a budget basis, using a modified accrual system of accounting, with revenues credited in the period in which they are collected and expenditures debited in the period in which the corresponding liabilities are incurred.

The annual budget is proposed by the Governor by January 10 of each year for the next fiscal year (the "Governor's Budget"). Under State law, the annual proposed Governor's Budget cannot provide for projected expenditures in excess of projected revenues and balances available from prior fiscal years. Following the submission of the Governor's Budget, the Legislature takes up the proposal.

Under the State Constitution, money may be drawn from the Treasury only through an appropriation made by law. The primary source of the annual expenditure authorizations is the Budget Act as approved by the Legislature and signed by the Governor. The Budget Act must be approved by a two-thirds majority vote of each House of the Legislature. The Governor may reduce or eliminate specific line items in the Budget Act or any other appropriations bill without vetoing the entire bill. Such individual line-item vetoes are subject to override by a two-thirds majority vote of each House of the Legislature.

Appropriations also may be included in legislation other than the Budget Act. Bills containing appropriations (except for K-14 education) must be approved by a two-thirds majority vote in each House of the Legislature and be signed by the Governor. Bills containing K-14 education appropriations only require a simple majority vote. Continuing appropriations, available without regard to fiscal year, may also be provided by statute or the State Constitution.

Funds necessary to meet an appropriation need not be in the State Treasury at the time such appropriation is enacted; revenues may be appropriated in anticipation of their receipt.

The General Fund

The moneys of the State are segregated into the General Fund and approximately 600 Special Funds. The General Fund consists of revenues received by the State Treasury and not required by law to be credited to any other fund, as well as earnings from the investment of State moneys not allocable to another fund. The General Fund is the principal operating fund for the majority of governmental activities and is the depository of most of the major revenue sources of the State. For additional financial data relating to the General Fund, see Exhibits 1 and 2 to this Appendix A. The General Fund may be expended as a consequence of appropriation measures enacted by the Legislature and approved by the Governor, as well as appropriations pursuant to various constitutional authorizations and initiative statutes.

The Special Fund for Economic Uncertainties

The Special Fund for Economic Uncertainties ("SFEU") is funded with General Fund revenues and was established to protect the State from unforeseen revenue reductions and/or unanticipated expenditure increases. Amounts in the SFEU may be transferred by the State Controller as necessary to meet cash needs of the General Fund. The State Controller is required to return moneys so transferred without payment of interest as soon as there are sufficient moneys in the General Fund.

The legislation creating the SFEU contains a continuous appropriation from the General Fund authorizing the State Controller to transfer to the SFEU, as of the end of each fiscal year, the lesser of (i) the unencumbered balance in the General Fund and (ii) the difference between the State's "appropriations subject to limitation" for the fiscal year then ended and its "appropriations limit" as defined in Section 8 of Article XIII B of the State Constitution and established in the Budget Act for that fiscal year, as jointly estimated by the State's Legislative Analyst's Office and the Department of Finance. For a further description of Article XIII B, see "State Appropriations Limit" below. In certain circumstances, moneys in the SFEU may be used in connection with disaster relief.

For budgeting and accounting purposes, any appropriation made from the SFEU is deemed an appropriation from the General Fund. For year-end reporting purposes, the State Controller is required to add the balance in the SFEU to the balance in the General Fund so as to show the total moneys then available for General Fund purposes.

The SFEU had not carried a positive balance on a budget basis for the past several years. For the 1996-97 Fiscal Year, the Legislature has appropriated $305 million to fund the SFEU. See "CURRENT STATE BUDGET--Summary of State Revenues and Expenditures" below.

Inter-Fund Borrowings

Inter-fund borrowing has been used for many years to meet temporary imbalances of receipts and disbursements in the General Fund. As of June 30, 1996, the General Fund had outstanding loans from the SFEU and Special Funds in the amount of $1.454 billion.

In the event the General Fund is or will be exhausted, the State Controller is required to notify the Governor and the Pooled Money Investment Board (the "PMIB," consisting of the State Director of Finance, the State Treasurer and the State Controller). The Governor may then order the State Controller to direct the transfer of all or any part of the moneys not needed in Special Funds to the General Fund from such Special Funds, as determined by the PMIB. All money so transferred must be returned to the Special Fund from which it was transferred as soon as there is sufficient money in the General Fund to do so. Transfers cannot be made from a Special Fund which will interfere with the objective for which such Special Fund was created, or from certain specific funds. When moneys transferred to the General Fund in any fiscal year from any Special Fund pursuant to the inter-fund borrowing mechanism exceed ten percent of the total additions to surplus available for appropriation as shown in the statement of operations of the preceding fiscal year as set forth in the annual report of the State Controller, interest must be paid on such excess at a rate determined by the PMIB to be the current earning rate of the Pooled Money Investment Account.

Although any determination of whether a proposed borrowing from one of the Special Funds is permissible, any such determination must be made with regard to the facts and circumstances existing at the time of the proposed borrowing. The Attorney General of the State has identified certain criteria relevant to such a determination. For instance, amounts in the Special Funds eligible for inter-fund borrowings are legally available to be transferred to the General Fund if a reasonable estimate of expected General Fund revenues, based upon legislation already enacted, indicates that such transfers can be paid from the General Fund promptly if needed by the Special Funds or within a short period of time if not needed. In determining whether this requirement has been met, the Attorney General has stated that consideration may be given to the fact that General Fund revenues are projected to exceed expenditures entitled to a higher priority than payment of internal transfers, i.e., expenditures for the support of the public school system and public institutions of higher education and the payment of debt service on general obligation bonds of the State. Any reduction in internal borrowable resources may increase the State's reliance on external borrowing to meet its cash flow requirements.

The following chart shows General Fund internal borrowable resources on June 30 of each of the Fiscal Years 1991-92 through 1995-96 (dollars in millions):

General Fund Internal Borrowable Resources

	June 30,				
	1992	**1993**	**1994**	**1995**	**1996**
Available Internal Borrowable Resources	$6,218.4	$4,788.2	$6,500.4	$5,376.0	$5,211.0
Outstanding Loans					
From Special Fund for Economic Uncertainties	1,335.8	43.3	-0-	-0-	20.3
From Special Funds and Accounts	4,699.3	3,015.8	4,015.0	-0-	1,433.7
Total Outstanding Internal Loans	6,035.1	3,059.1	4,015.0	-0-	1,454.0
Unused Internal Borrowable Resources†	$ 183.3	$1,729.1	$2,485.4	$5,376.0	$3,757.0

† In addition, the State had external borrowings represented by Revenue Anticipation Warrants, in the following amounts at the following dates: June 30, 1992: $475 million; June 30, 1993: $ 2.0 billion; June 30, 1994: $3.2 billion; June 30, 1995: $4.0 billion. See "STATE INDEBTEDNESS--Short-Term Borrowings."

SOURCE: State of California, Office of the State Controller.

Investment of Funds

Moneys on deposit in the State's Centralized Treasury System are invested by the Treasurer in the Pooled Money Investment Account (the "PMIA"). As of August 31, 1996, the PMIA held approximately $17.0 billion of State moneys, and $10.2 billion of moneys invested for 2,431 local governmental entities through the Local Agency Investment Fund ("LAIF"). The assets of the PMIA as of August 31, 1996 are shown in the following table:

Analysis of the Pooled Money Investment Account Portfolio

Type of Security	Amount (in millions)	Percent of Total
U.S. Treasury Bills and Notes	$ 8,004.4	29.4%
Commercial Paper (corporate)	6,807.9	25.1
Certificates of Deposits	5,165.0	19.0
Corporate Bonds	2,028.0	7.5
Federal Agency Securities	1,937.2	7.1
Bankers Acceptances	298.2	1.1
Bank Notes	960.1	3.5
Loans Per Government Code	1,842.4	6.8
Time Deposits	341.0	1.3
Repurchases	200.0	0.7
Reverse Repurchases	(405.5)	(1.5)
	$27,178.7	100.0%

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SOURCE: State of California, Office of the Treasurer.

The State's treasury operations are managed in compliance with the California Government Code and according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. The PMIA operates with the oversight of the Pooled Money Investment Board (consisting of the State Treasurer, the State Controller and the Director of Finance). The LAIF portion of the PMIA operates with the oversight of the Local Agency Investment Advisory Board.

The Treasurer does not invest in leveraged products or inverse floating rate securities. The investment policy permits the use of reverse repurchase agreements subject to limits of no more than 10 percent of the PMIA. All reverse repurchase agreements are cash matched either to the maturity of the reinvestment or an adequately positive cash flow date which is approximate to the maturity of the reinvestment.

The average life of the investment portfolio of the PMIA as of August 31, 1996 was 258 days.

State Warrants

No money may be drawn from the State Treasury except upon a warrant duly issued by the State Controller. The State Controller is obligated to draw every warrant on the fund out of which it is payable for the payment of money directed by State law to be paid out of the State Treasury; however, a warrant may not be drawn unless authorized by law and unless unexhausted specific appropriations provided by law are available to meet it. State law provides two methods for the State Controller to respond if the General Fund has insufficient "Unapplied Money" available to pay a warrant when it is drawn, referred to generally as "registered warrants" and "reimbursement warrants." "Unapplied Money" consists of money in the General Fund for which outstanding warrants have not already been drawn and which would remain in the General Fund if all outstanding warrants previously drawn and then due were paid. Unapplied Money may include moneys transferred to the General Fund from the SFEU and internal borrowings from the Special Funds (to the extent permitted by law).

If a warrant is drawn on the General Fund for an amount in excess of the amount of Unapplied Money in the General Fund, after deducting from such Unapplied Money the amount, as estimated by the State Controller, required by law to be set apart for obligations having priority over obligations to which such warrant is applicable, the warrant must be registered by the State Treasurer on the reverse side as not paid because of the shortage of funds in the General Fund. The State Controller then delivers such a "registered warrant" to persons or entities (e.g., employees, suppliers and local governments) otherwise entitled to receive payments from the State. A registered warrant bears interest at a rate designated by the PMIB up to a maximum of 5 percent per annum. Registered warrants have no fixed maturity date, but are redeemed when the Controller, with the approval of the PMIB, determines there would be sufficient Unapplied Money in the General Fund. The State Controller notifies the State Treasurer, who publishes a notice that the warrants in question are payable.

In lieu of issuing individual registered warrants to numerous creditors, there is an alternative procedure whereby the Governor, upon request of the State Controller, may create a General Cash Revolving Fund in the State Treasury which may borrow from other State special funds to meet payments authorized by law. The State Controller may then issue "reimbursement warrants" at competitive bid to reimburse the General Cash Revolving Fund, thereby increasing cash resources for the General Fund to cover required payments. The General Cash Revolving Fund is created solely to facilitate the issuance of registered reimbursement warrants. Reimbursement warrants have a fixed maturity date, and must be paid by the State Treasurer on their maturity date from any Unapplied Money in the General Fund and available therefor.

See "PRIOR FISCAL YEARS' FINANCIAL RESULTS" below and "STATE INDEBTEDNESS--Short-Term Borrowings" above for a discussion of warrants issued by the State during the 1991-92 Fiscal Year and thereafter to meet the State's cash needs.

Local Governments

The primary units of local government in California are the counties, ranging in population from 1,300 (Alpine) to over 9,000,000 (Los Angeles). Counties are responsible for the provision of many basic services, including indigent health care, welfare, courts, jails and public safety in unincorporated areas. There are also about 480 incorporated cities, and thousands of other special districts formed for education, utility and other services. The fiscal condition of local governments has been constrained since the enactment of "Proposition 13" in 1978, which reduced and limited the future growth of property taxes, and limited the ability of local governments to impose "special taxes" (those devoted to a specific purpose) without two-thirds voter approval. A recent California Supreme Court decision has upheld the constitutionality of an initiative statute, previously held invalid by lower courts, which requires voter approval for "general" as well as "special" taxes at the local level. Counties, in particular, have had fewer options to raise revenues than many other local government entities, and have been required to maintain many services.

In the aftermath of Proposition 13, the State provided aid from the General Fund to make up some of the loss of property tax moneys, including taking over the principal responsibility for funding local K-12 schools and community colleges. Under the pressure of the recent recession, the Legislature has eliminated the remnants of this post-Proposition 13 aid to entities other than K-14 education districts, although it has also provided additional funding sources (such as sales taxes) and reduced mandates for local services. See "PRIOR FISCAL YEARS' FINANCIAL RESULTS" below. Many counties continue to be under severe fiscal stress. While such stress has in recent years most often been experienced by smaller, rural counties, larger urban counties, such as Los Angeles, have also been affected. Orange County implemented significant reductions in services and personnel, and continues to face fiscal constraints in the aftermath of its bankruptcy, which had been caused by large investment losses in its pooled investment funds.

State Appropriations Limit

The State is subject to an annual appropriations limit imposed by Article XIII B of the State Constitution (the "Appropriations Limit"). The Appropriations Limit does not restrict appropriations to pay debt service on the Bonds or other voter-authorized bonds.

Article XIII B prohibits the State from spending "appropriations subject to limitation" in excess of the Appropriations Limit. "Appropriations subject to limitation," with respect to the State, are authorizations to spend "proceeds of taxes," which consist of tax revenues, and certain other funds, including proceeds from regulatory licenses, user charges or other fees to the extent that such proceeds exceed "the cost reasonably borne by that entity in providing the regulation, product or service," but "proceeds of taxes" exclude most state subventions to local governments, tax refunds and some benefit payments such as unemployment insurance. No limit is imposed on appropriations of funds which are not "proceeds of taxes," such as reasonable user charges or fees and certain other non-tax funds.

Not included in the Appropriations Limit are appropriations for the debt service costs of bonds existing or authorized by January 1, 1979, or subsequently authorized by the voters, appropriations required to comply with mandates of courts or the federal government, appropriations for qualified capital outlay projects, appropriations of revenues derived from any increase in gasoline taxes and motor vehicle weight fees above January 1, 1990 levels, and appropriation of certain special taxes imposed by initiative (e.g., cigarette and tobacco taxes). The Appropriations Limit may also be exceeded in cases of emergency.

The State's Appropriations Limit in each year is based on the limit for the prior year, adjusted annually for changes in State per capita personal income and changes in population, and adjusted, when applicable, for any transfer of financial responsibility of providing services to or from another unit of government. The measurement of change in population is a blended average of statewide overall population growth, and change in attendance at local school and community college ("K-14") districts. The Appropriations Limit is tested over consecutive two-year periods. Any excess of the aggregate "proceeds of taxes" received over such two-year period above the combined Appropriations Limits for those two years is divided equally between transfers to K-14 districts and refunds to taxpayers.

The Legislature has enacted legislation to implement Article XIII B which defines certain terms used in Article XIII B and sets forth the methods for determining the Appropriations Limit. California Government Code Section 7912 requires an estimate of the Appropriations Limit to be included in the Governor's Budget, and thereafter to be subject to the budget process and established in the Budget Act.

The following table shows the State's Appropriations Limit for the past four fiscal years and the current fiscal year.

State Appropriations Limit
(Millions)

	Fiscal Years				
	1992-93	1993-94	1994-95	1995-96	1996-97*
State Appropriations Limit	$ 35,010	$ 36,599	$ 37,544	$ 39,309	$ 42,002
Appropriations Subject to Limit	(27,474)	(29,855)	(31,621)	(32,838)	(34,963)
Amount (Over)/Under Limit	$ 7,536	$ 6,744	$ 5,933	$ 6,471	$ 7,039

* Estimated.

SOURCE: State of California, Department of Finance.

Proposition 98

On November 8, 1988, voters of the State approved Proposition 98, a combined initiative constitutional amendment and statute called the "Classroom Instructional Improvement and Accountability Act." Proposition 98 changed State funding of public education below the university level and the operation of the State Appropriations Limit, primarily by guaranteeing K-14 schools a minimum share of General Fund revenues. Under

Proposition 98 (as modified by Proposition 111, which was enacted on June 5, 1990), K-14 schools are guaranteed the greater of (a) in general, a fixed percent of General Fund revenues ("Test 1"), (b) the amount appropriated to K-14 schools in the prior year, adjusted for changes in the cost of living (measured as in Article XIII B by reference to State per capita personal income) and enrollment ("Test 2"), or (c) a third test, which would replace Test 2 in any year when the percentage growth in per capita General Fund revenues from the prior year plus one half of one percent is less than the percentage growth in State per capita personal income ("Test 3"). Under Test 3, schools would receive the amount appropriated in the prior year adjusted for changes in enrollment and per capita General Fund revenues, plus an additional small adjustment factor. If Test 3 is used in any year, the difference between Test 3 and Test 2 would become a "credit" to schools which would be the basis of payments in future years when per capita General Fund revenue growth exceeds per capita personal income growth. Legislation adopted prior to the end of the 1988-89 Fiscal Year, implementing Proposition 98, determined the K-14 schools' funding guarantee under Test 1 to be 40.3 percent of the General Fund tax revenues, based on 1986-87 appropriations. However, that percent has been adjusted to approximately 35 percent to account for a subsequent redirection of local property taxes, since such redirection directly affects the share of General Fund revenues to schools.

Proposition 98 permits the Legislature by two-thirds vote of both houses, with the Governor's concurrence, to suspend the K-14 schools' minimum funding formula for a one-year period. Proposition 98 also contains provisions transferring certain State tax revenues in excess of the Article XIII B limit to K-14 schools (see "STATE FINANCES--State Appropriations Limit" above).

During the recent recession, General Fund revenues for several years were less than originally projected, so that the original Proposition 98 appropriations turned out to be higher than the minimum percentage provided in the law. The Legislature responded to these developments by designating the "extra" Proposition 98 payments in one year as a "loan" from future years' Proposition 98 entitlements, and also intended that the "extra" payments would not be included in the Proposition 98 "base" for calculating future years' entitlements. By implementing these actions, per-pupil funding from Proposition 98 sources stayed almost constant at approximately $4,220 from Fiscal Year 1991-92 to Fiscal Year 1993-94.

In 1992, a lawsuit was filed, called *California Teachers' Association v. Gould*, which challenged the validity of these off-budget loans. As part of the negotiations leading to the 1995-96 Budget Act, an oral agreement was reached to settle this case. The settlement required adoption of legislation satisfactory to the parties to implement its terms, which has occurred. The court gave final approval of the settlement in late July, 1996.

The settlement provides, among other things, that both the State and K-14 schools share in the repayment of prior years' emergency loans to schools. Of the total $1.76 billion in loans, the State will repay $935 million by forgiveness of the amount owed, while schools will repay $825 million. The State share of the repayment will be reflected as an appropriation above the current Proposition 98 base calculation. The schools' share of the repayment will count as appropriations that count toward satisfying the Proposition 98 guarantee, or from "below" the current base. Repayments are spread over the eight-year period of 1994-95 through 2001-02 to mitigate any adverse fiscal impact. The Director of Finance has certified that a settlement has occurred, allowing approximately $351 million in appropriations from the 1995-96 Fiscal Year to be disbursed to schools in August 1996.

Substantially increased General Fund revenues, above initial budget projections, in the 1994-95 and 1995-96 fiscal years have resulted in retroactive increases in Proposition 98 appropriations from subsequent fiscal years' budgets. See "PRIOR FISCAL YEARS' FINANCIAL RESULTS - 1995-96 Fiscal Year" and "CURRENT STATE BUDGET - 1996-97 Budget" for a further discussion of these adjustments.

Sources of Tax Revenue

The following is a summary of the State's major revenue sources. Further information on State revenues is contained under "CURRENT STATE BUDGET" and "STATE FINANCES--Recent Tax Receipts" below.

Personal Income Tax

The California personal income tax, which in 1994-95 contributed about 44 percent of General Fund revenues, is closely modeled after the federal income tax law. It is imposed on net taxable income (gross income less exclusions and deductions). The tax is progressive with rates ranging from 1 to 9.3 percent. Personal, dependent and other credits are allowed against the gross tax liability. In addition, taxpayers may be subject to an alternative minimum tax ("AMT") which is much like the federal AMT. Legislation enacted in July 1991 added two new marginal tax rates, at 10 percent and 11 percent, effective for tax years 1991 through 1995. After 1995, the maximum personal income tax rate returned to 9.3 percent, and the AMT rate dropped from 8.5 percent to 7 percent.

The personal income tax is adjusted annually by the change in the consumer price index to prevent taxpayers from being pushed into higher tax brackets without a real increase in income.

Sales Tax

The sales tax is imposed upon retailers for the privilege of selling tangible personal property in California. Sales tax accounted for about 34 percent of General Fund revenue in 1994-95. Most retail sales and leases are subject to the tax. However, exemptions have been provided for certain essentials such as food for home consumption, prescription drugs, gas delivered through mains and electricity. Other exemptions provide relief for a variety of sales ranging from custom computer software to aircraft.

The breakdown of the 7.25 percent rate currently imposed on a statewide basis is:

• 5.00 percent represents the State General Fund tax rate.
• 2.00 percent is dedicated to cities and counties.

• 0.25 percent is dedicated to county transit systems.

Legislation in July 1991 raised the sales tax rate by 1.25 percent to its current level. Of this amount, 0.25 percent was added to the General Fund tax rate, and the balance was dedicated to cities and counties. One-half percent was a permanent addition to counties, but with the money earmarked to trust funds to pay for health and welfare programs whose administration was transferred to counties. Another 0.5 percent of the State General Fund tax rate that was scheduled to terminate after June 30, 1993 was extended until December 31, 1993 and allocated to local agencies for public safety programs. Voters in a special election on November 2, 1993 approved a constitutional amendment to permanently extend this 0.5 percent sales tax for local public safety programs.

Currently, 0.25 percent of the State tax rate may be terminated upon certification by the Director of Finance that the balance in the budget reserve for two consecutive years will exceed 4 percent of General Fund revenues. The 0.25 percent rate can be reinstated if the Director of Finance subsequently determines that the reserve will not exceed 4 percent of General Fund revenues.

Bank and Corporation Tax

Bank and corporation tax revenues, which comprised about 13 percent of General Fund revenue in 1994-95, are derived from the following taxes:

1. The franchise tax and the corporate income tax are levied at a 9.3 percent rate on profits, which will be reduced to 8.84 percent for income years beginning on or after January 1, 1997. The former is imposed on corporations for the privilege of doing business in California, while the latter is imposed on corporations which do not do business in California but which derive income from California sources.

2. Banks and other financial corporations are subject to the franchise tax plus an additional tax at the rate of 2.0 percent on their net income. This additional tax is in lieu of personal property taxes and business license taxes.

3. The alternative minimum tax (AMT) is similar to that in federal law. In general, the AMT is based on a higher level of net income computed by adding back certain tax preferences. This tax is imposed at a rate of 7 percent, and will be reduced to 6.65 percent effective for income years beginning on or after January 1, 1997.

4. Sub-Chapter S corporations are taxed at 1.5 percent of profits.

Insurance Tax

The majority of insurance written in California is subject to a 2.35 percent gross premium tax. For insurers, this premium tax takes the place of all other State and local taxes except those on real property and motor vehicles. Exceptions to the 2.35 percent rate are certain pension and profit-sharing plans which are taxed at the lesser rate of 0.50 percent, surplus lines and nonadmitted insurance at 3 percent and ocean marine insurers at 5 percent of underwriting profits. Insurance taxes comprised approximately 2.3 percent of General Fund revenues in 1994-95.

In November, 1988, voters approved Proposition 103, which mandated reductions and rebates for certain property and casualty insurance premiums. The measure also directed the State Board of Equalization to adjust the gross premiums tax rate to compensate for any resultant decrease in insurance tax revenue through the 1990 tax year. As a result, the State Board of Equalization increased the gross premiums tax rate from 2.35 percent to 2.37 percent for the 1989 tax year and to 2.46 percent for the 1990 tax year. For 1991 and beyond, the rate returned to 2.35 percent. According to the Board of Equalization, there is a potential liability from implementation of the offset rates used for Proposition 103. The Board's estimate is $60 million, which is based on the difference between the statutory rate and the rate the Board used for 1990.

Other Taxes

Other General Fund major taxes and licenses include: Estate, Inheritance and Gift Taxes, Cigarette Taxes, Alcoholic Beverage Taxes, Horse Racing Revenues and trailer coach license fees. These other sources totaled approximately 3 percent of General Fund Revenues in the 1994-95 Fiscal Year.

Special Fund Revenues

The California Constitution, codes and statutes specify the uses of certain revenue. Such receipts are accounted for in various Special Funds. In general, Special Fund revenues comprise three categories of income:

1. Receipts from tax levies which are allocated to specified functions, such as motor vehicle taxes and fees and certain taxes on tobacco products.

2. Charges for special services to specific functions, including such items as business and professional license fees.

3. Rental royalties and other receipts designated for particular purposes (e.g., oil and gas royalties).

Motor vehicle related taxes and fees accounted for about 60 percent of all Special Fund revenue in 1994-95. Principal sources of this income are motor vehicle fuel taxes, registration and weight fees and vehicle license fees. During the 1995-96 Fiscal Year, $7.7 billion was derived from the ownership or operation of motor vehicles. About $4.7 billion of this revenue was returned to local governments. The remainder was available for various State programs related to transportation and services to vehicle owners. These estimates (as well as those shown below in the table "Comparative Yield of State Taxes--All Funds" below) include the additional fees and taxes derived from the passage of Proposition 111 in June 1990.

On November 8, 1988, voters approved Proposition 99, which imposed, as of January 1, 1989, an additional 25 cents per pack excise tax on cigarettes, and a new, equivalent excise tax on other tobacco products. The initiative requires that funds from this tax be allocated to anti-tobacco education and research and indigent health services, and environmental and recreation programs. The Legislature, as part of the 1994-95 and 1995-96 Budget Acts, redirected a larger share of the Proposition 99 funds to indigent health care. These actions have been blocked by court orders, and are currently before the appellate court, after the State lost in the trial court. See "LITIGATION" below. Legislation enacted in 1993 added an additional 2 cents per pack excise tax for the purpose of funding breast cancer research.

Recent Tax Receipts

The following table shows the trend of major General Fund and total taxes per capita and per $100 of personal income since 1980-81.

Trend of State Taxes

	Taxes per Capita(a)		Taxes per $100 of Personal Income	
Fiscal Year	General Fund	Total	General Fund	Total
1980-81	$ 748.80	$ 840.97	$6.41	$7.20
1981-82	784.78	885.62	6.11	6.90
1982-83	788.83	901.39	5.88	6.72
1983-84	880.14	1,013.30	6.23	7.18
1984-85	988.34	1,124.85	6.42	7.31
1985-86	1,021.63	1,170.25	6.25	7.16
1986-87	1,158.18	1,307.41	6.77	7.64
1987-88	1,126.67	1,284.81	6.30	7.19
1988-89	1,255.49	1,430.39	6.69	7.63
1989-90	1,278.16	1,477.32	6.50	7.51
1990-91	1,228.58	1,453.03	5.96	7.05
1991-92	1,307.19	1,593.74	6.31	7.69
1992-93	1,252.06	1,540.60	5.86	7.21
1993-94	1,208.06	1,541.64	5.61	7.16
1994-95	1,292.79	1,592.09	5.85	7.20
1995-96(b)	1,393.60	1,704.58	5.96	7.29
1996-97(b)	1,431.67	1,745.91	5.88	7.17

(a) Data reflect population figures benchmarked to the 1990 Census.
(b) Estimated. See "CURRENT STATE BUDGET—1996-97 Fiscal Year."
SOURCE: State of California, Department of Finance.

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The following table gives the actual and estimated growth in revenues by major source from 1969-70 to 1996-97.

COMPARATIVE YIELD OF STATE TAXES—ALL FUNDS
1969-70 THROUGH 1996-97
(Accrual Basis)
(Thousands)

Year Ending June 30	Sales and Use	Personal Income	Bank and Corpo-ration(a)	Tobacco(b)	Inheri-tance, Estate and Gift(c)	Insurance(d)	Alcoholic Beverages(e)	Horse Racing(f)	Motor Vehicle Fuel(g)	Motor Vehicle Fees(h)
1970 . . .	$ 1,753,611	$ 1,152,053	$ 587,013	$236,878	$164,299	$ 136,733	$105,908	$ 58,244	$ 668,537	$ 498,992
1975 . . .	3,376,078	2,579,676	1,253,673	261,975	242,627	202,991	120,749	86,637	752,234	664,453
1980 . . .	6,623,521	6,506,015	2,510,039	290,043	465,611	446,228	138,940	127,002	852,752	1,096,640
1985 . . .	9,797,564	10,807,706	3,664,593	262,868	296,805	643,139	135,786	133,814	1,159,637	2,137,326
1986 . . .	10,317,930	11,413,040	3,843,024	258,141	252,810	839,939	132,262	131,592	1,194,172	2,515,295
1987 . . .	10,904,022	13,924,527	4,800,843	255,076	273,089	1,008,804	131,288	131,733	1,245,881	2,692,835
1988 . . .	11,650,531	12,950,346	4,776,388	250,572	304,148	1,158,321	128,734	132,208	1,293,254	2,966,334
1989 . . .	12,650,893	15,889,179	5,138,009	559,617	335,091	1,317,630	128,264	131,334	1,320,512	3,142,484
1990 . . .	13,917,771	16,906,568	4,965,389	787,076	388,527	1,167,684	128,524	135,962	1,349,146	3,305,711
1991 . . .	13,839,573	16,852,079	4,544,783	745,074	498,774	1,287,152	129,640	145,972	1,999,771	3,513,159
1992 . . .	17,458,521(i)	17,242,816(j)	4,538,451	726,064	446,696	1,167,307	321,352	127,845	2,457,229	4,369,862
1993 . . .	16,598,863(i)	17,358,751(j)	4,659,950	677,846	458,433	1,188,181	292,107	112,544	2,412,574	4,470,321
1994 . . .	16,857,369	17,402,976(j)	4,809,273	664,322	552,139	1,196,921	275,797	116,263	2,547,633	4,518,795
1995 . . .	17,758,933(k)	18,608,181(j)	5,685,618	674,727	595,238	998,868	268,957	107,605	2,685,731	4,749,594
1996(l) .	17,458,032	20,870,000	5,890,100	662,700	543,000	1,147,000	267,400	106,409	2,808,109	4,901,540
1997(l) .	18,356,181	22,218,401	5,861,971	648,400	578,000	1,089,000	263,700	104,905	2,847,849	5,063,240

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(a) Includes the corporation income tax and, commencing with 1989 data, the unitary election fee.

(b) Proposition 99, of 1988, increased the cigarette tax to $0.35 per pack and added an equivalent tax to other tobacco products. The Breast Cancer Act added $0.02 per pack effective January 1, 1994.

(c) Proposition 6, of 1982, repealed the inheritance and gift taxes and imposed an estate tax equal to the maximum allowable Federal estate tax credit, effective for decedents dying on or after June 8, 1982.

(d) The conclusion of litigation resulted in additional revenue of $51 million in 1987-88, $178 million in 1988-89, $7 million in 1990-91, $5 million in 1991-92, and in refunds of $46 million in 1993-94, and $200 million in 1994-95.

(e) Alcoholic beverage excise taxes were significantly increased effective July 15, 1991.

(f) Beginning with 1988-89, includes revenues from satellite wagering which were not included in prior years.

(g) Motor vehicle fuel tax (gasoline), use fuel tax (diesel and other fuels), and jet fuel

(h) Registration and weight fees, motor vehicle license fees and other fees.

(i) Reflects 0.5 percent temporary sales tax increase between July 1, 1991 and June 30, 1993, which was transferred to local governments after July 1, 1993.

(j) Reflects temporary increase in top marginal rate to 11 percent, which reverted to 9.3 percent for tax years after January 1, 1996.

(k) Includes "Realignment Portion" which is transferred to local governments.

(l) Estimated. See "PRIOR YEARS' FINANCIAL results - 1995-96 Fiscal Year" and "CURRENT STATE BUDGET--1996-97 Fiscal Year."

SOURCE: 1969-70 through 1994-95—State of California, Office of the Controller.
1995-96 and 1996-97—State of California, Department of Finance.

State Expenditures

The following table summarizes the major categories of State expenditures, including both General Fund and Special Fund programs.

GOVERNMENTAL COST FUNDS
Schedule of Expenditures by Function and Character
1990-91 to 1994-95 Fiscal Years
(In Thousands)

	1990-91	1991-92	1992-93	1993-94	1994-95
Function					
Legislative, Judicial, Executive					
Legislative	$ 226,452	$ 174,865	$ 170,061	$ 175,792	$ 180,769
Judicial	645,897	893,281	756,527	616,862	635,916
Executive	565,960	566,642	556,620	564,997	653,583
State and Consumer Services	540,651	605,668	567,778	630,515	697,555
Business, Transportation and Housing					
Business and Housing	247,027	250,379	402,439	224,217	225,398
Transportation	2,861,361	3,228,453	3,177,866	3,363,335	3,188,749
Trade and Commerce	---	---	24,992	34,122	47,595
Resources	1,313,030	1,177,053	1,078,435	1,088,492	1,141,488
Environmental Protection . .	---	296,672	346,786	510,274	459,492
Health and Welfare	14,112,465	16,273,206	15,728,495	15,953,388	16,675,380
Correctional Programs	2,528,298	2,735,073	2,693,576	3,074,471	3,280,762
Education					
Education—K through 12 .	15,194,287	17,268,507	15,699,317	13,820,462	14,973,978
Higher Education	6,113,086	6,135,704	5,344,174	4,951,535	5,436,640
General Government					
General Administration . . .	957,895	1,008,546	824,387	1,015,089	1,000,650
Debt Service	1,083,068	1,341,720	1,627,492	1,802,833	2,189,529
Tax Relief	987,700	834,392	811,558	473,707	480,430
Shared Revenues	2,910,926	3,017,429	3,113,325	3,162,558	3,188,090
Miscellaneous	127,275	(19,185)	(87,124)	(129,338)	(92,508)
Expenditure Adjustment for Encumbrances	(385,895)	(312,295)	154,566	(162,958)	694,288
Credits for Overhead Services by General Fund	(149,240)	(169,704)	(182,689)	(184,336)	(156,118)
Statewide Indirect Cost Recoveries	(23,932)	(24,919)	(37,432)	(35,399)	(31,132)
Total	$49,856,311	$55,281,487	$52,771,149	$50,950,618	$54,870,534
Character					
State Operations	$14,485,659	$14,956,129	$14,657,902	$15,322,082	$16,403,401
Local Assistance	35,096,858	40,146,513	37,696,530	35,166,791	37,680,952
Capital Outlay	273,794	178,845	416,717	461,745	786,181
Total	$49,856,311	$55,281,487	$52,771,149	$50,950,618	$54,870,534

SOURCE: State of California, Office of the State Controller.

PRIOR FISCAL YEARS' FINANCIAL RESULTS

Fiscal Years Prior to 1995-96

The 1989-90 Fiscal Year ended with revenues below estimates, so that the State's budget reserve (the Special Fund for Economic Uncertainties or "SFEU") was fully depleted by June 30, 1990. A recession began in mid-1990, which severely affected State General Fund revenues, and increased expenditures above initial budget appropriations due to greater health and welfare costs. The State's budget problems in recent years have also been caused by a structural imbalance in that the largest General Fund Programs -- K-14 education, health, welfare and corrections -- were increasing faster than the revenue base, driven by the State's rapid population growth. These pressures are expected to continue as population trends maintain strong demand for health and welfare services, as the school age population continues to grow, and as the State's corrections program responds to a "Three Strikes" law enacted in 1994, which requires mandatory life prison terms for certain third-time felony offenders.

As a result of these factors and others, from the late 1980's until 1992-93, the State had a period of budget imbalance. During this period, expenditures exceeded revenues in four out of six years, and the State accumulated and sustained a budget deficit in the SFEU approaching $2.8 billion at its peak at June 30, 1993. Starting in the 1990-91 Fiscal Year and for each fiscal year thereafter, each budget required multibillion dollar actions to bring projected revenues and expenditures into balance. The Legislature and Governor agreed on the following principal steps to produce Budget Acts in the years 1991-92 to 1994-95, including:

- significant cuts in health and welfare program expenditures;
- transfers of program responsibilities and funding from the State to local governments (referred to as "realignment"), coupled with some reduction in mandates on local government;
- transfer of about $3.6 billion in local property tax revenues from cities, counties, redevelopment agencies and some other districts to local school districts, thereby reducing State funding for schools under Proposition 98;
- reduction in growth of support for higher education programs, coupled with increases in student fees;
- maintenance of the minimum Proposition 98 funding guarantee for K-14 schools, and the disbursement of additional funds to keep a constant level of about $4,200 per K-12 pupil (see "STATE FINANCES - Proposition 98" above);
- revenue increases (particularly in the 1991-92 Fiscal Year budget), most of which were for a short duration;
- increased reliance on aid from the federal government to offset the costs of incarcerating, educating and providing health and welfare services to illegal immigrants, although during this time frame, most of the additional aid requested by the Administration was not received; and
- various one-time adjustments and accounting changes.

Despite these budget actions, as noted, the effects of the recession led to large, unanticipated deficits in the budget reserve, the SFEU, as compared to projected positive balances. By the 1993-94 Fiscal Year, the accumulated deficit was so large that it was impractical to budget to retire it in one year, so a two-year program was implemented, using the issuance of revenue anticipation warrants to carry a portion of the deficit over the end of the fiscal year. When the economy failed to recover sufficiently in 1993-94, a second two-year plan was implemented in 1994-95, again using cross-fiscal year revenue anticipation warrants to partly finance the deficit into the 1995-96 fiscal year. See "STATE INDEBTEDNESS--Short-Term Borrowings" above.

Another consequence of the accumulated budget deficits, together with other factors such as disbursement of funds to local school districts "borrowed" from future fiscal years and hence not shown in the annual budget, was to significantly reduce the State's cash resources available to pay its ongoing obligations. When the Legislature and the Governor failed to adopt a budget for the 1992-93 Fiscal Year by July 1, 1992, which would have allowed the State to carry out its normal annual cash flow borrowing to replenish its cash reserves, the State Controller issued registered warrants to pay a variety of obligations representing prior years' or continuing appropriations, and mandates from court orders. See "STATE FINANCES--State Warrants" above. Available funds were used to make constitutionally-mandated payments, such as debt service on bonds and warrants. Between July 1 and September 4, 1992, when the budget was adopted, the State Controller issued a total of approximately $3.8 billion of registered warrants.

During the past several fiscal years, the State was forced to rely increasingly on external debt markets to meet its cash needs, as a succession of notes and revenue anticipation warrants were issued in the period from June 1992 to July 1994, often needed to pay previously maturing notes or warrants. These borrowings were used also in part to spread out the repayment of the accumulated budget deficit over the end of a fiscal year, as noted earlier. The last and largest of these borrowings was $4.0 billion of revenue anticipation warrants issued in July, 1994 and maturing on April 25, 1996. See "STATE INDEBTEDNESS--Short Term Borrowings" above.

1995-96 Fiscal Year

With strengthening revenues and reduced caseload growth based on an improving economy, the State entered the 1995-96 Fiscal Year budget negotiations with the smallest nominal "budget gap" to be closed in many years. Nonetheless, serious policy differences between the Governor and Legislature prevented timely enactment of the budget. The 1995-96 Budget Act was signed by the Governor on August 3, 1995, 34 days after the start of the fiscal year. The Budget Act projected General Fund revenues and transfers of $44.1 billion, a 3.5 percent increase from the prior year. Expenditures were budgeted at $43.4 billion, a 4 percent increase. The Department of Finance projected that, after repaying the last of the carryover budget deficit, there would be a positive balance of $28 million in the budget reserve, the Special Fund for Economic Uncertainties, at June 30, 1996. The Budget Act also projected Special Fund revenues of $12.7 billion and appropriated Special Fund expenditures of $13.0 billion.

The Department of Finance's May Revision to the 1996-97 Governor's Budget, released on May 21, 1996 (the "May Revision"), updated the projections for the 1995-96 Fiscal Year, so that revenues and transfers were estimated to be $46.1 billion, some $2 billion over the original fiscal year estimate, which was attributed to the strong economic recovery. Expenditures also increased, to an estimated $45.4 billion, as a result of the requirement to expend revenues for schools under Proposition 98, and, among other things, failure of the federal government to enact welfare reform and to budget new aid for illegal immigrant costs, both of which the Administration had counted on to allow reductions in State costs. The Special Fund for Economic Uncertainties was projected to have a small negative balance of about $70 million at June 30, 1996, all but eliminating the accumulated budget deficit from the early 1990's. The Department also estimated that on June 30, 1996, available internal borrowable resources (available cash, after payment of all obligations due) would be about $4 billion, representing a significant improvement in the State's cash position, and ending the need for deficit borrowing over the end of the fiscal year. The State's improved cash position allowed it to repay the $4.0 billion Revenue Anticipation Warrant issue on April 25, 1996, and to issue only $2.0 billion of revenue anticipation notes during the fiscal year, which matured on June 28, 1996.

The following were the principal features of the 1995-96 Budget Act:

1. Proposition 98 funding for schools and community colleges was budgeted to increase by about $1.0 billion (General Fund) and $1.2 billion total above revised 1994-95 levels. Because of higher than projected revenues in 1994-95, an additional $561 million ($92 per K-12 ADA) was appropriated to the 1994-95 Proposition 98 entitlement. A large part of this was a block grant of about $50 per pupil for any one-time purpose. For the first time in several years, a full 2.7 percent cost of living allowance was funded. The budget compromise anticipated a settlement of the *CTA* v. *Gould* litigation. See "STATE FINANCES--Proposition 98" above.

2. Proposed cuts in health and welfare costs totaling about $0.9 billion. Some of these cuts (totaling about $500 million) required federal legislative or administrative approval, which has not yet been received. In 1995-96, approximately $220 million in cuts were made.

3. A 5.1 percent increase in funding for the University of California ($106 million General Fund) and the California State University system ($97 million General Fund), with no increases in student fees.

4. The Budget, as updated by the 1996-97 Governor's Budget dated January 10, 1996, assumed receipt of $494 million in new federal aid for incarceration and health care costs of illegal immigrants, above commitments already made by the federal government. Only $31 million of this total was actually received in 1995-96.

5. General Fund support for the Department of Corrections was increased by about 7 percent over the prior year, reflecting estimates of increased prison

population.

CURRENT STATE BUDGET

The discussion below of the 1996-97 Fiscal Year budget and the table under "Summary of State Revenues and Expenditures" below are based on estimates and projections of revenues and expenditures for the current fiscal year and must not be construed as statements of fact. These estimates and projections are based upon various assumptions which may be affected by numerous factors, including future economic conditions in the State and the nation, and there can be no assurance that the estimates will be achieved. See "CURRENT STATE BUDGET--Revenue and Expenditure Assumptions" below.

Periodic reports on revenues and expenditures during the fiscal year are issued by the Administration, the State Controller's Office and the Legislative Analyst's Office. The Department of Finance issues a monthly Bulletin which reports the most recent revenue receipts, comparing them to Budget projections, and reports on other current developments affecting the Budget. The Administration also formally updates its budget projections twice during each fiscal year, generally in January and May.

1996-97 Fiscal Year

Background

The 1996-97 Governor's Budget, released January 10, 1996, projected General Fund revenues and transfers of $45.6 billion, a 1.3% increase over 1995-96. Although an expected strong economy would generate larger revenue growth, the Governor proposed two major initiatives, a 15% personal and corporate income tax cut and a revision of the trial court funding program, which would have the effect of reducing General Fund revenues. The Governor's Budget proposed General Fund expenditures of $45.2 billion. The Governor's Budget also proposed Special Fund revenues equal to expenditures, at a level of $13.3 billion.

The May Revision of the Governor's Budget, released on May 21, 1996 ("May Revision"), updated revenue estimates for the 1996-97 Fiscal Year, reflecting stronger economic activity in the State and thus greater revenue growth. The revised estimate was for $47.1 billion of revenues, still assuming the Governor's tax cut would be enacted, and $46.5 billion of expenditures.

1996-97 Budget Act

The 1996-97 Budget Act was signed by the Governor on July 15, 1996, along with various implementing bills. The Governor vetoed about $82 million of appropriations (both General Fund and Special Fund). With signing of the Budget Act, the State implemented its regular cash flow borrowing program with the issuance of $3.0 billion of Revenue Anticipation Notes to mature on June 30, 1997. The Budget Act appropriates a modest budget reserve in the SFEU of $305 million, as of June 30, 1997. The Department of Finance projects that, on June 30, 1997, the State's available internal borrowable (cash) resources will be $2.9 billion, after payment of all obligations due by that date, so that no cross-fiscal year borrowing will be needed.

Revenues - The Legislature rejected the Governor's proposed 15% cut in personal income taxes (to be phased over three years), but did approve a 5% cut in bank and corporation taxes, to be effective for income years starting on January 1, 1997. As a result, revenues for the Fiscal Year will be an estimated $550 million higher than projected in the May Revision, and are now estimated to total $47.643 billion, a 3.3 percent increase over the final estimated 1995-96 revenues. Special Fund revenues are estimated to be $13.3 billion.

Expenditures - The Budget Act contains General Fund appropriations totaling $47.251 billion, a 4.0 percent increase over the final estimated 1995-96 expenditures. Special Fund expenditures are budgeted at $12.6 billion.

The following are principal features of the 1996-97 Budget Act:

1. Proposition 98 funding for schools and community college districts increased by almost $1.6 billion (General Fund) and $1.65 billion total above revised 1995-96 levels. Almost half of this money was budgeted to fund class-size reductions in kindergarten and grades 1-3. Also, for the second year in a row, the full cost of living allowance (3.2 percent) was funded. The Proposition 98 increases have brought K-12 expenditures to almost $4,800 per pupil (also called per ADA, or Average Daily Attendance), an almost 15% increase over the level prevailing during the recession years. Community colleges will receive an increase in funding of $157 million for 1996-97 out of this $1.6 billion total.

Because of the higher than projected revenues in 1995-96, an additional $1.1 billion ($190 per K-12 ADA and $145 million for community colleges) was appropriated and retroactively applied towards the 1995-96 Proposition 98 guarantee, bringing K-12 expenditures in that year to over $4,600 per ADA. These new funds were appropriated for a variety of purposes, including block grants, allocations for each school site, facilities for class size reduction, and a reading initiative. Similar retroactive increases totaling $230 million, based on final figures on revenues and State population growth, were made to the 1991-92 and the 1994-95 Proposition 98 guarantees, most of which was allocated to each school site.

2. The Budget Act assumed savings of approximately $660 million in health and welfare costs which required changes in federal law, including federal welfare reform. The Budget Act further assumed federal law changes in August 1996 which would allow welfare cash grant levels to be reduced by October 1, 1996. These cuts totaled approximately $163 million of the anticipated $660 million savings. See "Federal Welfare Reform" below.

3. A 4.9 percent increase in funding for the University of California ($130 million General Fund) and the California State University system ($101 million General Fund), with no increases in student fees, maintaining the second year of the Governor's four-year "Compact" with the State's higher education units.

4. The Budget Act assumed the federal government will provide

approximately $700 million in new aid for incarceration and health care costs of illegal immigrants. These funds reduce appropriations in these categories that would otherwise have to be paid from the General Fund. (For purposes of cash flow projections, the Department of Finance expects $540 million of this amount to be received during the 1996-97 fiscal year.)

5. General Fund support for the Department of Corrections was increased by about 7 percent over the prior year, reflecting estimates of increased prison population.

6. With respect to aid to local governments, the principal new programs included in the Budget Act are $100 million in grants to cities and counties for law enforcement purposes, and budgeted $50 million for competitive grants to local governments for programs to combat juvenile crime.

The Budget Act did not contain any tax increases. As noted, there was a reduction in corporate taxes. In addition, the Legislature approved another one-year suspension of the Renters Tax Credit, saving $520 million in expenditures.

Federal Welfare Reform - Following enactment of the 1996-97 Budget Act, Congress passed and the President signed (on August 22, 1996) the Personal Responsibility and Work Opportunity Act of 1996 (P.L. 104-193, the "Law") making a fundamental reform of the current welfare system. Among many provisions, the Law includes: (i) conversion of Aid to Families with Dependent Children from an entitlement program to a block grant titled Temporary Assistance for Needy Families (TANF), with lifetime time limits on TANF recipients, work requirements and other changes; (ii) provisions denying certain federal welfare and public benefits to legal noncitizens, allowing states to elect to deny additional benefits (including TANF) to legal noncitizens, and generally denying almost all benefits to illegal immigrants; and (iii) changes in the Food Stamp program, including reducing maximum benefits and imposing work requirements.

The Law requires states to implement the new TANF program not later than July 1, 1997 and provides California approximately $3.7 billion in block grant funds for FY 1996-97 for the provisions of the Law. States are allowed to implement TANF as soon as possible and will receive a prorated block grant effective the date of application. The California State Plan is to be submitted in time to allow grant reductions to be implemented effective January 1, 1997 (allowing $92 million of the $163 million referred to in ¶2 above to be saved) and to allow the State to capture approximately $267 million in additional federal block grant funds over the currently budgeted level. None of the other federal changes needed to achieve the balance of the $660 million cost savings were enacted. Thus, in lieu of the $660 million savings initially assumed to be saved, it is now projected that savings will total approximately $360 million.

A preliminary analysis of the Law by the Legislative Analyst's Office indicates that an overall assessment of how these changes will affect the State's General Fund will not be known for some time, and will depend on how the State implements the Law. There are many choices including how quickly the State implements the Law; the degree to which the State elects to make up for cuts in federal aid, provide more aid to counties, or cut some of its own existing programs for noncitizens; and the State's ability to avoid certain penalties written into the Law.

Summary of State Revenues and Expenditures

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE—GENERAL FUND (Modified Accrual Basis)[a] FISCAL YEARS 1992-93 THROUGH 1996-97 (Millions)

				Estimated[b]	
	1992-93	1993-94	1994-95	1995-96	1996-97
Fund Balance—Beginning of Period	$ (3,307.0)	$ (2,240.0)	$ (1,004.8)	$ (393.8)	219.0
Restatements					
Prior Year Revenue, Transfer Accrual Adjustments	(128.7)	159.2	(217.3)	(83.9)	--
Prior Year Expenditure, Accrual Adjustments	1,086.4	(88.4)	431.2	--	--
Adjustment to Prior Year Debt Service	--	247.9	--	--	--
Adjustment to Prior Year Reserve for Article XVI, Section 8 of the State Constitution (Proposition 98)	--	--	(261.2)[c]	--	--
Fund Balance—Beginning of Period, as Restated	$ (2,349.3)	$ (1,921.3)	$ (1,052.2)	$ (477.7)	219.0
Revenues	$ 40,238.8	$ 39,422.4	$ 42,375.3	$45,840.0	$47,585.7
Other Financing Sources					
Transfers from Other Funds	715.2	568.7	1,641.3	297.1	57.1
Other Additions	78.3	55.8	71.8	--	--
Total Revenues and Other Sources	$ 41,032.3	$ 40,046.9	$ 44,088.4	$46,137.1	$47,642.8
Expenditures					
State Operations	$ 9,555.9	$ 10,034.5	$ 10,972.5	$11,975.6	$12,138.7
Local Assistance	31,155.1[d]	28,846.2[d]	30,958.3	33,411.6	35,032.6
Capital Outlay	28.0	--	9.5	53.2	79.2
Other Uses					--
Transfer to Other Funds	184.0	249.7	1,489.7	--[e]	--[e]
Total Expenditures and Other Uses	$ 40,923.0	$ 39,130.4	$ 43,430.1	$45,440.4	$47,250.5
Revenues and Other Sources Over or (Under) Expenditures and Other Uses	$ 109.3	$ 916.5	$ 658.3	$ 696.7	$ 392.3
Fund Balance					
Reserved for Encumbrances	$ 372.0	$ 316.0	$ 306.3	$ 306.0	306.0
Reserved for Unencumbered Balances of Continuing Appropriations[f]	45.0	51.2	145.7	--	--
Reserved for Article XVI, Section 8 of the State Constitution[c] (Proposition 98)	150.9	261.2	--	--	--
Reserved for School Loans[g]	--	--	1,709.7	1,559.7	1,409.7
Unreserved—Undesignated[h]	$ (2,807.9)	$ (1,633.2)	$ (2,555.5)	(1,646.7)[i]	(1,104.4)[j]
Fund Balance—End of Period	$ (2,240.0)[k]	$ (1,004.8)[k]	$ (393.8)[k]	$ 219.0	$ 611.0

Footnotes on following page.

(a) These statements have been prepared on a modified accrual basis in accordance with State law and some modifications would be necessary in order to comply with generally accepted accounting principles ("GAAP"). See Exhibit 1 to this Appendix A for the audited general purpose financial statements of the State for the year ended June 30, 1995, prepared in accordance with generally accepted

(continued from prior page)

accounting principles. See Note 2 to the Financial Statements for a description of the differences between budgetary basis and GAAP basis.

(b) Estimates are shown net of reimbursements and abatements.

(c) Prior to the 1994-95 fiscal year, the unencumbered and reverted balances of certain appropriations that were restricted for future educational purposes were reserved within the fund balance of the General Fund. Beginning with the 1994-95 fiscal year, a liability will be recognized for the amount that previously had been reflected as the "Reserved for Article XVI, Section 8 of the State Constitution." This change in accounting treatment is being made in order to match expenditures with the K-14 schools' share of General Fund revenues, as computed in accordance with Proposition 98. The effect of the change is to decrease the beginning fund balance of the General Fund by $261 million.

(d) Approximately $1.1 billion of local school aid actually distributed in the 1991-92 Fiscal Year was not included in budget authority for that year but was instead intended to be reflected in the budget authority in the 1992-93 Fiscal Year as "repayment" of a loan made to school districts for the prior year. Because of a technical drafting error which was not corrected until after June 30, 1992, the Controller's financial report showed no reduction of 1991-92 budgeted expenditures; the inter-year shift is reflected as an adjustment in the 1992-93 financial report. The 1993-94 Budget Act contained a similar "repayment" in 1993-94 for a loan of $190 million of Proposition 98 funds in 1992-93. See "STATE FINANCES - Proposition 98" above.

(e) "Transfer to Other Funds" is included either in the expenditure totals detailed above or as "Transfer from Other Funds."

(f) Pursuant to Chapter 1238, Statutes of 1990, the unencumbered balances of continuing appropriations which exist when no commitment for an expenditures is made should be an item of disclosure, but the amount shall not be deducted from the fund balance. Accordingly, the General Fund condition included in the 1996-97 Governor's Budget includes the unencumbered balances of continuing appropriations as a footnote to the statement (including $101.1 million in 1994-95, $92.1 million in 1995-96 and $8.8 million in 1996-97). However, the State Controller's financial statements continue to reflect a specific reserve for the unencumbered balance for continuing appropriations.

(g) During 1995, a reserve was established in the General Fund fund balance for the $1.7 billion of previously recorded school loans which had been authorized by Chapter 703, Statutes of 1992 and Chapter 66, Statutes of 1993. These loans are deferred and are to be repaid from future General Fund appropriations. See "STATE FINANCES - Proposition 98" above for a discussion of the settlement of the CTA v. Gould lawsuit. This accounting treatment is consistent with the State's audited financial statements prepared in accordance with GAAP.

(h) Includes Special Fund for Economic Uncertainties (SFEU).

(i) Includes SFEU balance of ($87.0 million).

(j) Includes SFEU balance of $305 million.

(k) The 1993-94 Budget Act contained a plan to retire the projected $2.8 billion accumulated deficit over an 18-month period, to December, 1994, in part by using external borrowing in the form of revenue anticipation warrants. See "STATE INDEBTEDNESS — Short-Term Borrowing" above. The 1994-95 Budget Act reflected a further deferral of $1.025 billion of accumulated deficit to the 1995-96 Fiscal Year. These plans are not reflected in this table.

SOURCE: Fiscal Years 1992-93 to 1994-95: State of California, Office of the Controller.
Fiscal Years 1995-96 and 1996-97: State of California, Department of Finance.

Revenue and Expenditure Assumptions

The table below presents the Department of Finance's budget basis (accrual) statements of major General Fund revenue sources and expenditures for the 1994-95 and 1995-96 Fiscal Years and estimated for the 1996-97 Fiscal Year.

Revenues
($ in millions)

Source	Fiscal Year 1994-95	Original Fiscal Year 1995-96†	Revised Fiscal Year 1995-96††	Estimated Fiscal Year 1996-97††
Personal Income Tax	$18,500	$19,915	$20,870	$22,218
Sales and Use Tax	14,630	15,509	15,690	16,486
Bank and Corporation Tax	5,708	5,055	5,890	5,862
Insurance Tax	999	1,179	1,147	1,089
All Other	2,873	2,399	2,540	1,988
Total Revenues and Transfers . .	$42,710	$44,057	$46,137	$47,643

Expenditures
($ in millions)

Function	Fiscal Year 1994-95(a)	Original Fiscal Year 1995-96†(a)	Revised Fiscal Year 1995-96 ††(a)	Estimated Fiscal Year 1996-97††(a)
K-12 Education	$15,533	$16,404	$17,539	$19,063
Health and Welfare	13,960	13,857	14,350	14,466(b)
Higher Education	5,102	5,380	5,572	6,033
Youth and Adult Correctional . . .	3,625	3,575	3,965	3,866(c)
Legislative, Judicial and Executive	1,338	1,388	1,449	1,279
Tax Relief	477	458	463	469
Resources	735	742	856	703
State and Consumer Services	323	357	362	362
Business, Transportation and Housing	256	276	274	319
All Other	612	984	611	691
Total Expenditures	$41,961	$43,421	$45,441	$47,251

(a) Estimates assumed Proposition 98 funding will be based on settlement of *CTA v. Gould*. See "STATE FINANCES--Proposition 98." Estimates also assumed AFDC payments, health care costs and pension fund payments at currently enacted levels. See discussion of *Beno v. Shalala, Welch v. Anderson, American Lung Association of California v. Wilson* and *P.E.R.S. v. Wilson* in "LITIGATION" below.
(b) The Department of Finance projects receipt of additional federal funds of $216 million in 1996-97 for health and welfare costs associated with illegal immigrants, which reduce a like amount of General Fund expenditures.
(c) The Department of Finance projects receipt of additional federal funds of $484 million in 1996-97 for incarceration costs associated with illegal immigrants, which reduce a like amount of General Fund expenditures.
† 1995-96 Budget Act.
†† 1996-97 Budget Act.

SOURCE: State of California, Department of Finance.

The Revenue and Expenditure assumptions set forth above have been based upon certain estimates of the performance of the California and national economies in 1996 and 1997. As set forth in the May Revision of the 1996-97 Governor's Budget, released on May 21, 1996, the Department of Finance projects that, despite some slowdown in the national economy, California will continue steady economic growth, as it recovers from the recent recession. The Department set out the following estimates which were used in predicting revenues and expenditures for the 1995-96 and 1996-97 Fiscal Year Budgets; also set forth are the Department's most recent previous estimates as set forth in the 1996-97 Governor's Budget, released January 10, 1996:

Economic Assumptions

	1996		1997	
	Governor's Budget	May Revision	Governor's Budget	May Revision
Nonfarm wage and salary employment (000)	12,790	12,791	13,085	13,118
Percent Change	2.6	2.7	2.3	2.6
Personal income ($ billions)	798.6	795.0	846.0	843.0
Percent Change	5.7	6.1	5.9	6.0
Housing Permits (Units 000)	113	101	133	121
Consumer Price Index Percent Change	2.3	2.7	2.6	3.1

SOURCE: State of California, Department of Finance, January 10, 1996 (for "Governor's Budget") and May, 1996 (for "May Revision").